Supreme Court, U.S.
FILED
(1)

01 888 DEC 11 2001

OFFICE OF THE CLERK

No. ____

In The

Supreme Court of the United States

CHOICE HOTELS INTERNATIONAL, INC.,

Petitioner,

v.

JAMES L. TICKNOR; JANET TICKNOR; LARRY TICKNOR; TICKCO HOLDING, L.L.C.; AND TICKNOR LODGING CORPORATION,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

JAMES G. HEALY
Counsel of Record
10750 Columbia Pike
Silver Spring, Maryland 20901
(301) 592-6230

Counsel for Petitioner

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

72 pp

QUESTIONS PRESENTED FOR REVIEW

1. Whether a court may refuse to enforce, on unconscionability grounds due to lack of mutuality or inadequate consideration, an arbitration agreement in a contract to which the Federal Arbitration Act (9 U.S.C. § 1 et seq.) applies based upon a state court decision applicable to arbitration agreements but not applicable to all contracts under state law, and applicable to consumer contracts of adhesion but not yet extended to sophisticated business parties by that state court.

2. Whether the existence of mutual promises by parties to a contract to arbitrate at least some claims precludes a finding that a contract to which the Federal Arbitration Act is applicable is unenforceable due to unconscionability resulting from lack of mutuality or inadequate consideration, particularly where the state law to be applied by a federal court sitting in diversity requires construction of contractual obligations in such a way as to make the obligations imposed mutually binding.

3. Whether a court may base its refusal to honor a choice of law provision in a contract upon a state law policy that invalidates arbitration agreements due to a state policy regarding unconscionability for lack of mutuality or inadequacy of consideration in a state where other contracts are not invalidated for those reasons.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Supreme Court Rule 29.6, petitioner Choice Hotels International, Inc. states that it has no parent companies or subsidiaries, and that no publicly held company owns 10% or more of its stock.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

CORPORATE DISCLOSURE STATEMENT ii

TABLE OF AUTHORITIES iii

OPINIONS BELOW 1

JURISDICTION 1

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 1

STATEMENT OF THE CASE 2

A. STATUTORY BACKGROUND 3

B. FACTUAL AND PROCEDURAL BACKGROUND 4

C. PROCEEDINGS IN THE DISTRICT COURT 7

D. PROCEEDINGS IN THE NINTH CIRCUIT 9

REASONS FOR GRANTING THE WRIT 13

I. THE DECISION OF THE NINTH CIRCUIT CONFLICTS WITH THE CLEAR LANGUAGE OF THE FAA AND WITH THIS COURT'S DECISIONS IN *ERIE* AND *KLAXON* 14

II. THE DECISION OF THE NINTH CIRCUIT CONFLICTS WITH THIS COURT'S DECISION IN *CASAROTTO* 17

III. THE CONFLICT BETWEEN THE NINTH CIRCUIT AND SEVERAL OTHER CIRCUITS REQUIRES RESOLUTION BY THIS COURT ... 21

CONCLUSION 23

TABLE OF AUTHORITIES

Page

CASES

All-States Leasing Company v. Top Hat Lounge, Inc., 198 Mont. 1, 649 P.2d 1250 (1982) 16

Bayma v. Smith Barney, Harris Upham and Co., 784 F.2d 1023 (9th Cir. 1986) 11

Burger King Corp. v. Rudzewicz, 471 U.S. 462 (1985) 9

Choice Hotels International, Inc. v. BSR Tropicana Resort, Inc., 252 F.2d 707 (4th Cir. 2001) 16

Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (1988) 11

Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681 (1996) 14, 18, 21

Doctor's Associates, Inc. v. Distajo, 66 F.3d 438 (2d Cir. 1995) 22

Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938) 15, 17, 20

Harris v. Green Tree Financial Corporation, 183 F.3d 173 (3d Cir. 1999) 22

Hodgkiss v. Northland Petroleum Consol, 104 Mont. 328, 67 P.2d 811 (1937) 19

Hooters of America, Incorporated v. Phillips, 173 F.3d 933 (1999) 22

In re Michael, 264 Mont. 261, 871 P.2d 272 (1994) 16

Iwen v. U.S. West Direct, 293 Mont. 512, 977 P.2d 989 (1999) ..... *passim*

Johnson v. Circuit City Stores, 148 F.3d 373 (4th Cir. 1998), *cert. denied*, 530 U.S. 1276 (2000) 21

TABLE OF AUTHORITIES Continued

Page

Klaxon Co. v. Stentor Electric Mfg. Co., 313 U.S. 487 (1941) 15, 17, 20

Koveleskie v. SBC Capital Markets, Inc., 167 F.3d 361 (7th Cir. 1999) 23

Kroll v. Doctor's Associates, Inc., 3 F.3d 1167 (1993) 23

Michalski v. Circuit City Stores, Inc., 177 F.3d 634 (7th Cir. 1999) 22

Miller v. Titeca, 192 Mont. 357, 628 P.2d 670 (1981) 19

Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) 3

O'Neil v. Hilton Head Hospital, 115 F.3d 272 (4th Cir. 1997) 21

Pederson v. Thoeny, 88 Mont. 569, 295 P. 250 (1930) 19

Perry v. Thomas, 482 U.S. 483 (1987) 18

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) 4

Rudio v. Yellowstone Merchandising Corp., 200 Mont. 537, 652 P.2d 1163 (1982) 19

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) 3

State ex rel. Mountain States Telephone and Telegraph Company v. District Court of the Second Judicial District in and for the County of Silver Bow, 160 Mont. 443, 503 P.2d 526 (1972) 19, 20

Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468 (1989) 18

Wandell v. Johnson, 71 Mont. 73, 227 P. 58 (1924) 16, 19

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTIONAL PROVISION

U.S. CONST. art. VI, cl. 2 2

STATUTES

28 U.S.C. § 1254(1) 1

28 U.S.C. § 1332 7

28 U.S.C. § 1441 7

Federal Arbitration Act

9 U.S.C. § 1 ..... 2, 3

9 U.S.C. § 2 ..... 3, 17

9 U.S.C. § 16 1

Montana Code Ann. § 28-2-801 19

87A-2-719, R.C.M. 1947 20

OTHER AUTHORITY

Restatement (Second) of Conflict of Laws § 188 7

PETITION FOR A WRIT OF CERTIORARI

Choice Hotels International, Inc. respectfully petitions this Honorable Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit (App., *infra*, 1a-22a) is reported at 265 F.3d 931. The district court opinion (App., *infra*, 23a-34a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on September 12, 2001. That order is appealable pursuant to the Federal Arbitration Act, 9 U.S.C. § 16, which provides that an appeal may be taken from an order refusing a stay of any action under section 3 of that title. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of the Constitution of the United States provides, in pertinent part, that "the Laws of the United States . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any

State to the Contrary notwithstanding." U.S. CONST. art. VI, cl. 2.

The relevant sections of the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* ("FAA"), are reproduced at App., *infra*, 35a-38a.

STATEMENT OF THE CASE

This case presents questions of broad importance and issues having far-reaching implications for arbitration agreements in contracts involving interstate commerce, as well as the ability of parties to enforce them throughout the United States on a uniform basis and unfettered by state judicial rulings rendering them unenforceable, contrary to the express language and clear intent of both the Federal Arbitration Act ("FAA") and the rulings of this Court. In upholding the order of the district court denying a motion by Choice Hotels International, Inc. ("Choice") to compel arbitration of an action brought in connection with a contract containing an arbitration agreement, the Ninth Circuit has effectively endorsed the efforts of a state court that would impose strictures upon agreements to arbitrate and has granted to the courts of that State the prerogative to judicially review the adequacy of consideration in arbitration contracts and dictate the terms upon which parties may arbitrate, a function they may not exercise under state law with respect to contracts generally.

A. STATUTORY BACKGROUND

The Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, provides that written agreements to arbitrate disputes arising out of transactions involving interstate commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The FAA "reverses centuries of judicial hostility to arbitration agreements" [*Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510 (1974)] and permits "parties to an arbitrable dispute [to move] out of court and into arbitration as quickly and as easily as possible." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 22 (1983):

> The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a defense to arbitrability.

Id., 460 U.S. at 24-25.

A court is empowered to stay an action and compel arbitration pursuant to the explicit provisions of Sections 2, 3 and 4 of the FAA:

> Section 2 provides that a written provision for arbitration "in any maritime transaction or a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." Section 3 requires a federal court in which suit has been brought "upon any issue

> referable to arbitration under an agreement in writing for such arbitration" to stay the court action pending arbitration once it is satisfied that the issue is arbitrable under the agreement. Section 4 provides a federal remedy for a party "aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration," and directs the federal court to order arbitration once it is satisfied that an agreement for an arbitration has been made and has not been honored.

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 400 (1967).

B. FACTUAL AND PROCEDURAL BACKGROUND

On or about March 10, 1998, Ticknor Lodging Corporation, a South Dakota corporation, and James L. Ticknor entered into a franchise agreement with Choice, a Maryland franchisor of hotel brands, pursuant to which they were granted a license to operate a hotel located in Bozeman, Montana under the Econo Lodge® marks of Choice in exchange for the payment of certain fees. App., *infra*, 23a-24a. On the same date, Janet Ticknor, Larry Ticknor and Tickco Holding, L.L.C. entered into a contract with Choice in which they agreed to guaranty the performance of Ticknor Lodging and James L. Ticknor throughout the term of their franchise agreement with Choice, including each and every covenant, payment or obligation contained therein.[1] *Id.*

---

[1] With Ticknor Lodging Corporation and James L. Ticknor, the guarantors are referred to herein collectively as "the Ticknors" or "respondents."

The franchise agreement contained two addenda amending its terms which, *inter alia*, reduced the liability of the Ticknors for liquidated damages in the event of their termination under the terms of the franchise agreement. App., *infra*, 32a.

The franchise agreement contained an arbitration clause which provides as follows:[2]

> Except for our claims against you for indemnification, actions for collection of moneys owed us under this Agreement, or actions seeking to enjoin you from using the Marks in violation of this Agreement, any controversy or claim relating to this Agreement, or the breach of this Agreement, including any claim that this Agreement or any part of this Agreement is invalid, illegal, or otherwise voidable or void, will be sent to final and binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitrator will apply the substantive laws of Maryland, without reference to its conflict of laws provision. Judgment on the arbitration award may be entered in any court having jurisdiction. If any party fails to appear at any properly noticed arbitration proceeding, an award may be entered against the party, notwithstanding its failure to appear. Any arbitration will be conducted at our headquarters office in Maryland.

App., *infra*, 29a-30a. The franchise agreement also contained a choice of law provision which provided that

---

[2] Throughout the contract, "we" and "our" refer to Choice, while "you" refers to respondents.

"[t]his Agreement becomes valid only when we have signed it, and it will be interpreted under the substantive laws of Maryland, not including its conflict of laws provision." *Id.*

On March 23, 1999, Choice forwarded a notice of termination of the franchise agreement to James L. Ticknor and Ticknor Lodging Corporation in which Choice notified them and the guarantors that the franchise agreement was terminated, effective immediately, due to unremedied material defaults in the performance of their duties under the Agreement, specifically, their failure to pay outstanding franchise and related fees pursuant to the terms of the agreement. App., *infra*, 23a-24a. On or about July 8, 1999, Choice filed a demand for arbitration against the Ticknors with the American Arbitration Association seeking payment of past franchise fees and damages for profits lost due to the premature termination of the franchise agreement. *Id.*

Instead of responding to the arbitration proceedings, the Ticknors on August 9, 1999 filed a complaint against Choice in the Montana state court for rescission, breach of contract, negligent misrepresentation, and fraud in connection with the franchise agreement (App., *infra.*, 31a), along with a motion to enjoin the arbitration proceeding, which was granted *ex parte* by the state court judge on the same date. App., *infra.*, 24a. Choice then removed the action to the United States District Court for the District of Montana, Butte Division, and filed a motion pursuant to the Federal Arbitration Act to dismiss the action or, in the alternative, to stay it and compel its arbitration. App., *infra.*, 24a-25a. The basis for the jurisdiction of the district

court was diversity of citizenship pursuant to 28 U.S.C. § 1332 and the removal provisions of 28 U.S.C. § 1441.

The district court denied the motion of respondents for a temporary restraining order on September 9, 1999 and scheduled a hearing on their motion for a preliminary injunction. App., *infra*, 25a. At the September 15, 1999 oral argument on the motion for preliminary injunction, Choice agreed to delay the arbitration proceedings until after the pending motions could be heard. *Id.* Choice withdrew the demand for arbitration it had previously filed with the American Arbitration Association on October 9, 1999, and filed a notice of the withdrawal of the arbitration with the district court on October 18, 1999. *Id.*

C. PROCEEDINGS IN THE DISTRICT COURT

On December 6, 1999, the district court entered an order denying the motion of Choice to dismiss or stay the action and to compel arbitration of respondents' claims. App., *infra*, 23a-34a. The lower court first held that a clause specifying that Maryland law should be applied to the resolution of disputes between the parties would not be enforced because, under state conflict of laws provisions, the choice of law provision would be "contrary to a fundamental policy of a state (Montana) which has a materially greater interest than the chosen state in the determination of the particular issue and which . . . would be the state of the applicable law in the absence of an effective choice of law by the parties." App., *infra*, 26a. In support of this finding, the district court evaluated the five factors enumerated in Restatement (Second) of Conflict of Laws § 188 to be used in determining the state

which has a materially greater interest in an issue, finding with respect to the "place of contracting" that the contract was signed both in Montana and Maryland (App., *infra*, 27a), a finding the Ninth Circuit would later characterize as inaccurate due to fact that the contract was actually executed by James Ticknor in Mexico at a time when he was a Colorado resident (App., *infra*, 8a-9a); that negotiations took place in Montana (App., *infra*, 27a), despite the district court's concurrent and inconsistent finding that the contract was one of adhesion as to which there had been no opportunity to negotiate (App., *infra*, 32a); that the "place of performance" and the "subject matter" of the contract were "rooted in Montana" because respondents' hotel was located in Montana (App., *infra*, 27a), despite the district court's acknowledgment that the Ticknors mailed their franchise and related fees to Maryland and that the franchise agreement required Choice to provide the Ticknors with a license to use the Econo Lodge® trademarks, access to Choice's reservation system, and the benefits of national advertising (App., *infra*, 24a, 27a); and that respondents were located in Montana (App., *infra*, 27a), another finding the Ninth Circuit found to be inaccurate due to the fact that Larry and Janet Ticknor were located in South Dakota, not Montana (App., *infra*, 8a-9a).

Having concluded that Montana had a greater material interest in the agreement, and that the law of Montana would govern the dispute absent a choice by the parties of the law of another state, the trial court went on to find that the "determination of unconscionability issues under another state's law would be contrary to Montana's fundamental policy of protecting its citizens

from agreements that are contrary to Montana's fundamental policies" and that "[a]pplying Maryland law to determine this issue would be unconscionable." App., *infra*, 27a-28a.

In determining whether or not the arbitration clause in the contract between Choice and respondents was unconscionable under Montana law, the district court cited to and considered a single Montana case, *Iwen v. U.S. West Direct*, 293 Mont. 512, 977 P.2d 989 (1999), which involved an agreement to arbitrate printed on the back of an order form for local telephone directory advertising ordered by a consumer, and held that the arbitration clause in the contract between Choice and respondents was unconscionable because Choice reserved "the right of access to the courts and to juries for itself alone," adding that Choice could not enforce the clause against the Ticknors regardless of whether "it lacks consideration under Maryland law or is unconscionable under Montana law"[3] (App., *infra*, 33a) and denied Choice's arbitration motion.

D. PROCEEDINGS IN THE NINTH CIRCUIT

A divided panel of the Ninth Circuit, over a dissent by Judge Tashima, affirmed the district court. Although it

---

[3] Although the district court also mentioned the fact that "Choice required its franchisees to travel to Maryland, a hardship that a court of law could not impose because of due process requirements for personal jurisdiction," this ground was not mentioned by the Ninth Circuit in its own opinion and would clearly constitute an erroneous finding in any event under *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985).

found the lower court's findings with respect to two of the five factors to be erroneous,[4] the court of appeals agreed with the conclusion of the former that "Montana has a materially greater interest than Maryland in the transaction," concurring with the finding of the trial court that "the purpose of the contract was to establish and govern operation of a motel franchise in Montana," and adding several factors not set forth in Restatement (Second) of Conflict of Laws § 188 but which are often seen in the context of an analysis of contacts for the purpose of determining whether a federal court may exercise personal jurisdiction over a party, including the facts that "the only face-to-face meeting between Choice representatives and James Ticknor occurred in Montana," "James Ticknor never traveled to Maryland," and "Maryland provided an address for depositing payments, but little else." App., *infra*, 9a.

Instead of at that juncture determining whether or not Maryland law would conflict with that of Montana regarding the enforceability of contract provisions being challenged on unconscionability grounds, the court of appeals found that, if Maryland law differed from that of

---

[4] Based upon these statements by the court of appeals regarding the inaccuracy of certain of the factual findings of the district court, it is clear that, of the five factors used to evaluate the materiality of state interests for purposes of determining choice of law in the absence of a choice of law provision, two of them (place of contracting and place of domicile) favor Choice; one of them (place of negotiation) is inapplicable; and two of them (place of performance and location of subject matter) have elements related to both Maryland and Montana.

Montana, then Montana law would apply because Montana public policy requires the application of the decision of the Montana Supreme Court barring enforcement of "an arbitration clause that 'lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter' " (citing *Iwen, supra,* at 977 P.2d 996). App., *infra,* 10a. The court of appeals made this finding on the basis of *Iwen* and in the absence of any Montana state law extending the principles set forth in that case from the consumer context to commercial contracts between sophisticated parties.

Having concluded that *Iwen* was applicable and that it would also be applicable in the context of sophisticated business owners, the panel majority found that the arbitration provision in the contract between Choice and respondents was a contract of adhesion that "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter." App., *infra,* 14a. It went on to state that the decision in *Iwen* was not preempted by the Federal Arbitration Act because "Montana law pertaining to the unconscionability of arbitration clauses (is) the result of the 'application of general principles that exist at law or in equity for the revocation of any contract.' " *Iwen, id.* In affirming the lower court's ruling, the panel went on to reconsider and overrule the prior Ninth Circuit decisions in *Cohen v. Wedbush, Noble, Cooke, Inc.,* 841 F.2d 282 (1988), and *Bayma v. Smith Barney, Harris Upham and Co.,* 784 F.2d 1023 (9th Cir. 1986) to the extent that those cases held that "state law adhesion principles may not be invoked to bar arbitrability of disputes under the Arbitration Act." App., *infra,* 16a.

In his dissenting opinion, Judge Tashima stated that, in his view, the arbitration contract was neither a contract of adhesion nor so one-sided as to make it unconscionable, that Maryland law should be applied to the case, and that the decision of the lower court should be reversed. Judge Tashima collected and described those Montana cases relating to contracts of adhesion, pointing out that Montana had "used the adhesion doctrine to protect unsophisticated consumers in *consumer* transactions with no meaningful choice," and that the "rule of adhesion has never been applied to commercial contracts between sophisticated business organizations." (Emphasis in original). App., *infra*, 18a. Judge Tashima also pointed out that the Ticknors were not unsophisticated consumers, nor had they shown they had no other viable alternatives to entering into the contract, or that they, for example, faced the possibility of being excluded from the hotel franchise market unless they accepted a contract with such an agreement to arbitrate, facts in direct contrast with those in *Iwen*. App., *infra*, 19a-20a.

With regard to the terms of the arbitration clause, itself, Judge Tashima pointed out that, "should either party wish to proceed against the other for almost any obligation *under the contract*, that party must do so through arbitration (emphasis in original)," pointing out that, by contrast, the consumer contract in *Iwen* contained a single remedy for both parties, i.e., the cost of the advertisement, but that the telephone company could enforce that remedy in court, while the consumer was limited to pursuit in arbitration. App., *infra*, 20a-21a.

Judge Tashima also pointed out the distinction previously noted by the Ninth Circuit between "procedural

unconscionability (related to the manner and circumstances of contract formation, i.e., was it truly a contract of adhesion), and substantive unconscionability (which analyzes the terms of the agreement, i.e., is so one-sided as to *shock the conscience*) (emphasis in original)," and suggested that the panel should have proceeded using the same analysis, under which the agreement between Choice and respondents was "clearly not an unenforceable adhesion contract." App., *infra*, 22a.

Finally, Judge Tashima stated the view that, because the arbitration clause does not violate Montana law, the parties' choice of law should have been enforced and Maryland law, which would treat the mutual promises to arbitrate as an independently enforceable contract, should have been applied by the lower court.

REASONS FOR GRANTING THE WRIT

The decision of the Ninth Circuit has expanded considerably the grounds upon which a federal court sitting in diversity may invalidate agreements to arbitrate that are subject to the FAA based upon a prediction that the State of Montana would extend the law relating to adhesion contracts and unconscionability principles from consumer transactions to those involving sophisticated business parties, as opposed to state law principles that currently exist. In doing so, it has also set a precedent that would permit courts to examine the adequacy of consideration in all agreements to arbitrate that contain mutual, though not always identical, obligations to arbitrate, even those that do not "shock the conscience."

The decision of the Ninth Circuit is also in direct conflict with the FAA and decisions of this Court, which require that agreements to arbitrate as to which the FAA is applicable be valid, irrevocable, and enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract," including the ruling in *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996), as the state law decision relied upon by the court of appeals was applicable only to arbitration clauses, and not to all contracts generally.

Finally, the decision of the Ninth Circuit conflicts with decisions upholding similar arbitration agreements against challenges based upon lack of mutuality, lack of consideration and unconscionability in the Second Circuit, Third Circuit, Fourth Circuit, Seventh Circuit and Eighth Circuit. Only this Court can properly clarify further the boundaries upon the power of the district courts and state courts to apply state law principles to render unenforceable arbitration agreements in contracts subject to the FAA, and it is likely that the already abundant litigation on these issues will continue absent such clarification.

I. THE DECISION OF THE NINTH CIRCUIT CONFLICTS WITH THE CLEAR LANGUAGE OF THE FAA AND WITH THIS COURT'S DECISIONS IN *ERIE* AND *KLAXON*

Section 2 of the FAA provides for the revocation of arbitration agreements only upon "such grounds as *exist* at law or in equity for the revocation of any contract." (Emphasis supplied.) The law does not, by its terms,

grant courts the right to revoke arbitration agreements based upon speculation or predictions as to what the law may be at some point in the future or based upon such grounds for revocation as at one time may have existed but which are no longer recognized, nor do any decisions of this Court provide an interpretation of the FAA that would support such a proposition.

Except in matters governed by the Constitution or by acts of Congress, a federal court sitting in diversity must apply the law of the state in which it sits. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938). This Court has also stated that the proper function of a federal court employing a conflict of laws analysis "is to ascertain what the state law is, not what it ought to be." *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 497 (1941).

Both the district court and the Ninth Circuit in the instant case ignored the basic principles of *Erie* and *Klaxon*. From its reading of the Montana Supreme Court decision in *Iwen*, the district court divined a broad policy in the State of Montana declaring the arbitration clauses in form contracts used in transactions between experienced business parties to be contracts of adhesion and, if the rights or obligations of the parties to the agreements differed, unenforceable as unconscionable. This reading, however, ignored the facts of *Iwen*, which involved an arbitration clause set forth on the back of a purchase order form for a telephone directory advertisement submitted by a consumer to the directory company, not sophisticated business entities entering into a long-term relationship involving substantial obligations. It also ignored the fact that Montana case law prior to that

decision had not expressed a such a policy; to the contrary, at least one prior Montana holding was to the effect that "[a]lthough courts have readily applied the doctrine of unconscionability to contracts between consumers and skilled businessmen, they are reluctant to rewrite the terms of a contract between businessmen themselves." *All-States Leasing Company v. Top Hat Lounge, Inc.*, 198 Mont. 1, 6, 649 P.2d 1250, 1253 (1982).

The Ninth Circuit also elected to extend the holding of *Iwen* to contracts between skilled businesspersons. In doing so, it cited *In re Michael*, 264 Mont. 261, 266, 871 P.2d 272, 275 (1994), for the proposition that "[o]ppression and a disparity of bargaining power are the indicia of unconscionability relating to a sales contract between two business professionals," without pointing out that the court in that case concluded that there was no unconscionability evident from the difference between purchase price and market price of an item, and that such a consideration would not be material to such a determination.

Even though it was improper for the Ninth Circuit to apply Montana law to the disputes in question in the first instance, even if that course of action were appropriate, it is plain that the district court could not have discharged its obligation to apply the law of Montana as it existed if it failed to observe established state law principles relating to the interpretation of contracts. Under Montana law, a "contract should be construed in such a way as to make the obligations imposed by its terms mutually binding upon the parties, unless such construction is wholly negatived by the language used." *Wandell v. Johnson*, 71 Mont. 73, 227 P. 58, 60 (1924). *Cf. Choice Hotels International, Inc. v. BSR Tropicana Resort, Inc.*, 252 F.2d 707 (4th

Cir. 2001) (holding that an arbitration clause identical to that in the instant case required Choice to arbitrate its claims for breach of contract, while claims for collection of moneys owed were excepted from the scope of the clause). Instead of acknowledging this principle of Montana law and applying it in this case, the Ninth Circuit ignored it and instead relied upon inapplicable precedents relating to an unconscionability principle which the Supreme Court of Montana had not yet definitively applied to transactions between sophisticated business parties. Accordingly, the Ninth Circuit violated its obligations under *Erie*, and its failure to apply Montana law constituted error.

In light of the foregoing status of Montana law, the Ninth Circuit could not, without doing violence to the principles set forth in *Erie* and *Klaxon*, find Montana law to be as it found it. While it is plain that Montana law has not extended the holding of *Iwen* to other cases, even if it could be found that some decisions supported such a reading, the fact that other decisions clearly conflicted with the interpretation of those cases by the court of appeals should have prevented it from speculating as to which line of cases Montana courts would ultimately adopt, and its speculation in that regard was erroneous.

II. THE DECISION OF THE NINTH CIRCUIT CONFLICTS WITH THIS COURT'S DECISION IN *CASAROTTO*

This Court has stated that "the text of § 2 (of the FAA) declares that state law may be applied *'if* that law arose to govern issues concerning the validity,

revocability, and enforceability of contracts generally (emphasis in original).' " *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 686-687 (1996), citing *Perry v. Thomas*, 482 U.S. 483, 492, n.9 (1987). "Courts may not, however, invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." *Casarotto*, 517 U.S. at 687. It has further been made clear that "a court may not 'rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect . . . what the state legislature cannot.' " *Id.* at 687 n.3. To the extent that such a state decision or legislative requirement is inconsonant with the FAA and its purpose of "ensuring that private agreements to arbitrate are enforced according to their terms," *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989), it is preempted by that federal law. *Casarotto*, 517 U.S. at 688.

In passing upon the arbitration agreement in the contract between Choice and respondents, the Ninth Circuit found it to be unenforceable because it "allowed Choice to bring its claims against Ticknor into state or federal court, yet forced (respondents) to submit all claims to binding arbitration" and that, as a result, it lacked " 'mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter.' " App., *infra*, 14a, citing *Iwen*, 977 P.2d at 996. Even a cursory review of Montana cases on the ability of courts to inquire into the adequacy of consideration reveals, however, that such a law is not applied to Montana contracts generally. Montana recognizes the "rule . . . that inadequacy of consideration, standing

alone, is not a sufficient ground for refusing to enforce an agreement." *Hodgkiss v. Northland Petroleum Consol*, 104 Mont. 328, 67 P.2d 811, 814 (1937); *Pederson v. Thoeny*, 88 Mont. 569, 295 P. 250, 252 (1930).

Similarly, Montana courts do not examine the nature of promises to assure that they are identical, mirror images of each other, and have held that a "contract should be construed in such a way as to make the obligations imposed by its terms mutually binding upon the parties, unless such construction is wholly negatived by the language used." *Wandell v. Johnson*, 71 Mont. 73, 227 P. 58, 60 (1924). Further, "mutual promises alone are enough to constitute valid consideration" under Montana law (*Miller v. Titeca*, 192 Mont. 357, 364-365, 628 P.2d 670, 675 (1981), *citing* Mont. Code Ann. § 28-2-801), and "relinquishment of a legal or contract right is sufficient consideration to support a contract." *Rudio v. Yellowstone Merchandising Corp.*, 200 Mont. 537, 544, 652 P.2d 1163, 1167 (1982).

Further evidence of the fact that the principles of *Iwen* have been applied only to arbitration agreements and not to other contracts under Montana law is found in *State ex rel. Mountain States Telephone and Telegraph Company v. District Court of the Second Judicial District in and for the County of Silver Bow*, 160 Mont. 443, 503 P.2d 526 (1972). In that case, suit was brought by two business customers of a telephone company for damages due to the failure of the latter to list them in a directory, despite their written order requesting one. The Montana Supreme Court directed the lower court to enter summary judgment in favor of the utility based upon a limitation of

liability provision contained in the General Exchange Tariff of the company, despite arguments by the plaintiffs that the provision was unconscionable. The court stated that the "mere fact of claimed unequal bargaining position does not render it" unconscionable, and further noted that a "[l]imitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not." 503 P.2d at 531 (*citing* 87A-2-719, R.C.M. 1947). The only salient difference between this case and *Iwen* is the fact that *Iwen* related to an arbitration clause and *Mountain States* did not.

For the same reasons, the Ninth Circuit could not, without running afoul of the principles set out in *Casarotto* and *Perry*, employ a choice of law and conflicts of law analysis that would have the effect of invalidating the arbitration agreement. While *Erie* and *Klaxon* make plain that a federal court will apply a choice of law analysis based upon state conflict of laws principles in the State in which it sits, the application of those principles must necessarily yield to the language and intent of the FAA, and if the application of those principles would, through the application of a "public policy" hostile to, or applicable only to, agreements to arbitrate instead of to all contracts generally, that analysis cannot be permitted to void the choice of law made by the parties in their contract. A contrary rule would permit a court to do indirectly what a State may not do directly.

The foregoing authorities make clear that the principles declared by the Montana Supreme Court in *Iwen* in connection with the arbitration clause in that case are not

applicable to contracts generally under Montana law. As a result, those principles may not be applied to the arbitration contract between Choice and respondents, as such rules would be preempted by the FAA under *Casarotto* and *Perry*.

III. THE CONFLICT BETWEEN THE NINTH CIRCUIT AND SEVERAL OTHER CIRCUITS REQUIRES RESOLUTION BY THIS COURT

The opinion of the Ninth Circuit is at odds with the decisions of every other federal court of appeals that has considered the issue of whether an arbitration agreement containing varying obligations and rights on the part of the parties to the agreement should be enforced. In *O'Neil v. Hilton Head Hospital*, 115 F.3d 272, 275-276 (4th Cir. 1997), the district court denied a motion to stay an action filed by an employer in connection with the claim by an employee, who argued that the promise to arbitrate her claims was not supported by adequate consideration, but the Fourth Circuit reversed, holding that because the employer and employee both agreed to be bound by the results of the arbitration, the agreement was enforceable, as a "mutual promise to arbitrate constitutes sufficient consideration for this arbitration agreement."

Similarly, in *Johnson v. Circuit City Stores, Inc.*, 148 F.3d 373, 378 (4th Cir. 1998), *cert. denied*, 530 U.S. 1276 (2000), the district court found that an employment agreement signed by an employee of Circuit City was unenforceable due to lack of consideration because Circuit City failed to affirmatively promise to incur any detriment in exchange for the employee's agreement to arbitrate her

claims against the company, but the Fourth Circuit reversed, finding that since "both parties in this case agreed to be bound by the arbitration process for the resolution of any claim required to be submitted to arbitration under the Dispute Resolution Agreement," the agreement "was supported by adequate consideration," despite the fact that Circuit City was not required to arbitrate any claims it might have had against the employee. *Cf. Hooters of America, Incorporated v. Phillips*, 173 F.3d 933, 938 (1999) (finding that the employer had breached its contractual obligation to promulgate rules and procedures for arbitration by "providing a mechanism for selecting a panel of three arbitrators that is crafted to ensure a biased decisionmaker" from a list of arbitrators created by the employer and otherwise creating rules that were completely one-sided).

The Third Circuit in *Harris v. Green Tree Financial Corporation*, 183 F.3d 173, 183 (3d Cir. 1999) also found that parties to an agreement were not required "to have equivalent obligations to satisfy the standard of mutuality of obligation," and that "the mere fact that Green Tree retains an option to litigate some issues in court, while the Harrises must arbitrate all claims does not make the arbitration agreement unenforceable." The Second Circuit has even gone beyond this principle to hold that mutuality of obligation or remedy is not required to enforce an arbitration agreement if the underlying contract is supported by consideration. *Doctor's Associates, Inc. v. Distajo*, 66 F.3d 438, 451-453 (2d Cir. 1995).

In *Michalski v. Circuit City Stores, Inc.*, 177 F.3d 634, 636 (7th Cir. 1999), the Seventh Circuit reversed the order of the district court denying a motion to stay or dismiss

the action or compel arbitration noting the "Circuit City's promise to be bound by the arbitration process itself serves as mutual consideration." Along the same lines was the decision of the Seventh Circuit in *Kroll v. Doctor's Associates, Inc.*, 3 F.3d 1167, 1171 (1993), in which the court, in response to a claim of lack of mutuality of obligation, stated that "parties can agree to arbitrate some disputes and not others." *Cf. Koveleskie v. SBC Capital Markets, Inc.*, 167 F.3d 361, 366 (7th Cir. 1999), *cert. denied*, 528 U.S. 811 (1999) (finding that a mandatory arbitration agreement contained in a securities industry form "does not create an unconscionable contract of adhesion").

The foregoing cases amply demonstrate not only that the issues involved in the opinion of the Ninth Circuit in the instant case are recurring themes in the development of arbitration law but also that the treatment of these issues by the Ninth Circuit here was *sui generis* among the courts of appeal.

CONCLUSION

The petition for a writ of certiorari in this case should be granted.

Respectfully submitted,

JAMES G. HEALY
10750 Columbia Pike
Silver Spring, MD 20901
(301) 592-6230

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JAMES L. TICKNOR; JANET TICKNOR; LARRY TICKNOR; TICKCO HOLDING, L.L.C.; TICKNOR LODGING CORPORATION, Plaintiffs-Appellees, v. CHOICE HOTELS INTERNATIONAL, INC., Defendant-Appellant.	No. 00-35048 D.C. No. CV-99-00047-DWM OPINION

Appeal from the United States District Court
for the District of Montana
Donald W. Molloy, District Judge, Presiding

Argued and Submitted
July 19, 2001 – Bozeman, Montana

Filed September 12, 2001

Before: Harry Pregerson, A. Wallace Tashima and Sidney R. Thomas, Circuit Judges.

Opinion by Judge Thomas;
Dissent by Judge Tashima

COUNSEL

Patrick M. Sullivan; Butte, Montana; Attorney for the appellant.

Robert K. Baldwin; Bozeman, Montana; Attorney for the appellee

---

OPINION

THOMAS, Circuit Judge:

In this appeal, we consider whether the Federal Arbitration Act preempts state law governing the unconscionability of adhesion contracts. Under the circumstances presented by this case, we conclude that it does not, and we affirm the order of the district court denying the motion to compel arbitration.

I

In 1998, James Ticknor and the Ticknor Lodging Corporation (collectively, "Ticknor") executed an Econo Lodge Franchise Agreement ("Franchise Agreement") with Choice Hotels, International, Inc. ("Choice") for the operation of a hotel located in Bozeman, Montana. In return for the payment of franchise fees, Ticknor was granted a non-exclusive license to use the Econo-Lodge mark in connection with the motel. In addition, Choice was to integrate the motel into its national advertising and reservations system and provide other assistance. James Ticknor's parents, Janet and Larry Ticknor and Tickco Holding LLC (their company) guaranteed the performance of the Agreement. Ticknor and Ticknor Lodging also executed the separate guaranty agreement ("Guaranty Agreement").

The Franchise Agreement, which was a pre-printed standard form instrument drafted by Choice, contained an arbitration clause providing:

> Except for our claims against you for indemnification, actions for collection of moneys owed us under this Agreement, or actions seeking to enjoin you from using the Marks in violation of this Agreement, any controversy or claim relating to this Agreement, or the breach of this Agreement, including any claim that this Agreement or any part of this Agreement is invalid, illegal, or otherwise voidable or void, will be sent to final and binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitrator will apply the substantive laws of Maryland, without reference to its conflict of laws provision. Judgment on the arbitration award may be entered in any court having jurisdiction. If any party fails to appear at any properly noticed arbitration proceeding, an award may be entered against the party, notwithstanding its failure to appear. Any arbitration will be conducted at our headquarters office in Maryland.

The Franchise Agreement also contained a choice of law provision that stated: "This Agreement becomes valid only when we have signed it, and it will be interpreted under the substantive laws of Maryland, not including its conflict of laws provision."

The Guaranty Agreement did not contain either an arbitration clause or a choice of law provision. However, it did provide in relevant part that:

> the undersigned do jointly and severally, unconditionally and irrevocably, guaranty to Choice

> that Ticknor Lodging Corporation . . . and James L. Ticknor, Individually, Jointly and Severally, . . . will perform throughout the term of the Agreement each and every covenant, payment or obligation on the part of the Franchisee contained and set forth in said Agreement.

Subsequently, the parties executed two contract addendums drafted by Choice. The first reduced the amount of liquidated damages potentially payable. The second required Ticknor to make certain facility improvements, but allowed him to operate the motel pending implementation of some of those upgrades. According to Ticknor, Choice had promised to provide technical and financial assistance in the renovation of the motel exterior through its "Signature Exterior Renovation Program."

The ink was hardly dry on the Franchise Agreement when disputes arose. Choice canceled the "Signature Exterior Renovation Program," which Ticknor claims was a material inducement to his assent to the Franchise Agreement. In addition, Ticknor alleges that the Choice reservation system was flawed, resulting in overbookings. As a result of these disagreements, Ticknor suspended payment of the franchise fee. Choice thereupon notified Ticknor that it was suspending the Franchise Agreement. Choice also filed a demand for arbitration with the American Arbitration Association ("AAA"), whereupon Ticknor sought and received a state court temporary restraining order prohibiting Choice from proceeding with arbitration. Choice then removed the state court action to federal court and filed a motion to dismiss or, alternatively, to compel arbitration. The district court

declined Ticknor's application for a temporary restraining order. Choice withdrew its arbitration request with the AAA. After an evidentiary hearing, the district court denied Choice's motion to dismiss and alternative motion to compel arbitration. This appeal followed.

We review *de novo* a district court's order denying a petition to compel arbitration, including its interpretation of the validity and scope of the arbitration clause. *Chiron Corp. v. Ortho Diagnostic Sys. Inc.*, 207 F.3d 1126, 1130 (9th Cir. 2000). "[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). We review the factual findings underlying the district court's decision for clear error. *Woods v. Saturn Distrib. Corp.*, 78 F.3d 424, 427 (9th Cir. 1996). The interpretation and meaning of contract provisions are questions of law we review *de novo*. *Simula, Inc. v. Autoliv, Inc.*, 175 F.3d 716, 719 (9th Cir. 1999). We also review *de novo* the district court's decision concerning the appropriate choice of law. *Aceves v. Allstate Ins. Co.*, 68 F.3d 1160, 1167 (9th Cir. 1995).

II

The Federal Arbitration Act ("FAA") provides that written agreements to arbitrate disputes arising out of transactions involving interstate commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The FAA " 'creates a body of federal substantive law of arbitrability,' enforceable in both state and federal courts and pre-empting any state

laws or policies to the contrary." *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988) (quoting *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24).

Despite the "liberal federal policy favoring arbitration agreements," *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 81 (2000), state law is not entirely displaced from federal arbitration analysis. Under § 2, "state law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) (emphasis in original). "Thus, generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 686 (1996). "Courts may not, however, invalidate arbitration agreements under state laws applicable only to arbitration provisions." *Id.* Thus, "Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.' " *Id.* (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 (1974)). In short, as long as state law defenses concerning the validity, revocability, and enforceability of contracts are generally applied to all contracts, and not limited to arbitration clauses, federal courts may enforce them under the FAA.

Of course, the role of the federal courts in these circumstances is limited: the sole question is whether the arbitration clause at issue is valid and enforceable under § 2 of the Federal Arbitration Act. *Chiron Corp.*, 207 F.3d at 1130. In making this determination, federal courts may

not address the validity or enforceability of the contract as a whole. *Prima Paint v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 401 (1967).

III

Ticknor has raised the state law defense of unconscionability to Choice's motion to compel arbitration. Before assessing whether that defense is viable, we must determine which state's law applies. Federal courts sitting in diversity look to the law of the forum state in making a choice of law determination. *Sparling v. Hoffman Constr. Co., Inc.*, 864 F.2d 635, 641 (9th Cir. 1988); *see also Zinser v. Accufix Research Institute, Inc.*, ___ F.3d ___ (9th Cir. 2001). Thus, because the complaint was filed in Montana, Montana's choice of law rules apply.

Montana applies the Restatement (Second) of Conflict of Laws § 187(2) "when [it is] faced with the question of whether to give effect to a contractual choice of law by the parties." *Keystone, Inc. v. Triad Sys. Corp.*, 971 P.2d 1240, 1242 (1998). That section provides, in relevant part, that:

> The law of the state chosen by the parties to govern their contractual rights and duties will be applied . . . unless . . .
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the role of section 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Restatement (2d) of Conflict of Laws § 187(2) (1988).

Montana courts conflate the latter two inquiries and find that whichever state has a materially greater interest under § 188 is also the state whose law would apply absent an effective choice of law provision. *See Keystone*, 971 P.2d at 1242. Thus, to overcome the parties' choice of law contractual provisions, (1) Montana must have a materially greater interest in the transaction than Maryland and (2) application of the law of Maryland must be contrary to a fundamental public policy of Montana in the determination of the arbitration clause's validity.

To determine which state has a materially greater interest, Montana law relies on the five factors enumerated in Restatement (Second) of Conflict of Laws § 188, namely:

> (a) the place of contracting;
>
> (b) the place of negotiation of the contract;
>
> (c) the place of performance;
>
> (d) the location of the subject matter of the contract; and
>
> (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

Keystone, 971 P.2d at 1242.

After applying these factors, the district court determined that Montana has a materially greater interest than Maryland in the transaction. In making this analysis, the district court made the following factual findings:

> (a) The contract was signed in both Montana and Maryland.

(b) Negotiations took place between James Ticknor and a Choice representative in Montana.

(c) Most of the contract obligations were performed in Montana (i.e., the operation of the hotel by the Ticknors), except that the Ticknors mailed fees to Maryland.

(d) The subject matter of the contract – the Econo-Lodge motel – is located in Butte, Montana.

(e) The Ticknors live and work in Montana

These findings were inaccurate in some respects: James Ticknor executed the contract not in Montana, but on vacation in Mexico while he was a Colorado resident; Larry and Janet Ticknor were residents of South Dakota, not Montana; and the motel is located in Bozeman – not Butte. However, the discrepancies do not alter our agreement with the district court's ultimate conclusion that Montana has a materially greater interest than Maryland in the transaction. The purpose of the contract was to establish and govern operation of a motel franchise in Montana. The motel was operated in Montana. The only face-to-face meeting between Choice representatives and James Ticknor occurred in Montana. James Ticknor has never traveled to Maryland. Maryland provided an address for depositing payments, but little else. As in *Keystone*, "the contract was performed almost exclusively in Montana" and "the subject matter of the contract is located in Montana." 971 P.2d at 1243. Thus, under Montana choice of law principles, Montana has a materially greater interest in the transaction than does Maryland.

Having determined this, the second question is whether application of the law of Maryland in this context would be contrary to a fundamental public policy of Montana. Assuming, *arguendo*, that Maryland law would differ from Montana's on the salient question, application of foreign law would contradict a fundamental public policy of Montana. The Montana Supreme Court has taken a broad view of what constitutes public policy, declaring that "[f]or choice of law purposes, the public policy of a state is simply the rules, as expressed in its legislative enactments and judicial decisions, that it uses to decide controversies." *Phillips v. Gen. Motors Corp.*, 298 Mont. 438, 995 P.2d 1002, 1015 (2000). The Montana Supreme Court has also expressed antipathy toward choice of law provisions that might require enforcement of a contractual provision that would be invalid under Montana law. *See, e.g., Miller v. Fallon County*, 721 P.2d 342, 347 (1986) (holding that contracts with non-Montana choice of law provisions that violate public policy are "the types of contracts Montana will refuse to recognize regardless of their origin").

In the context of adhesion contracts, the Montana Supreme Court has determined expressly that it will not enforce an arbitration clause that "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter." *Iwen v. U.S. West Direct*, 293 Mont. 512, 977 P.2d 989, 996 (1999). In short, an unconscionable arbitration clause in an adhesion contract is unenforceable in Montana as a matter of public policy. Thus, the district court did not err in concluding that the Montana Supreme Court would likely hold that another

state's contrary interpretation of contract unconscionability would contradict a fundamental public policy of Montana. For these reasons, the district court also properly concluded that the question of whether the arbitration clause was unconscionable should be determined by application of Montana law.

IV

"The task of a federal court in a diversity action is to approximate state law as closely as possible in order to make sure that the vindication of the state right is without discrimination because of the federal forum." *Gee v. Tenneco, Inc.*, 615 F.2d 857, 861 (9th Cir. 1980). In doing so, federal courts are bound by the pronouncements of the state's highest court on applicable state law. *Davis v. Metro Productions, Inc.*, 885 F.2d 515, 524 (9th Cir. 1989). "Where the state's highest court has not decided an issue, the task of the federal courts is to predict how the state high court would resolve it." *Dimidowich v. Bell & Howell*, 803 F.2d 1473, 1482 (9th Cir. 1986), *modified at* 810 F.2d 1517 (9th Cir. 1987). In assessing how a state's highest court would resolve a state law question – absent controlling state authority – federal courts look to existing state law without predicting potential changes in that law. *Moore v. R.G. Industries, Inc.*, 789 F.2d 1326, 1327 (9th Cir. 1986).

The district court concluded that, under Montana law, the arbitration provision in the Franchise Agreement is unenforceable as unconscionable. In making that determination, the district court relied on the Montana Supreme Court's recent decision in *Iwen*, 977 P.2d at

994-95, in which the Montana Supreme Court invalidated an arbitration agreement almost identical to the provision at issue.

To determine the enforceability of a specific contractual provision under *Iwen*, a Montana court must first decide whether the contract is one of adhesion. 977 P.2d at 994-95. If so, then the provision will not be enforced against the weaker contracting party if it is (1) not within that party's reasonable expectations, or (2) if within those expectations, it is unduly oppressive, unconscionable, or against public policy. 977 P.2d at 994-95 (citing *Passage v. Prudential-Bache Sec., Inc.*, 727 P.2d 1298, 1302 (1986)).

The district court concluded that the Franchise Agreement was a contract of adhesion under Montana law, and we find no error in that determination. Like the contract at issue in *Iwen*, the Franchise Agreement was a standardized, form agreement that Ticknor was forced to accept or reject without negotiation. Choice argues that the presence of two addenda indicate that the contract was negotiable. However, the record belies this. The addenda were drafted by Choice after a site visit and presented to Ticknor in the same "take it or leave it" manner as the original Franchise Agreement. There is no evidentiary support in the record for Choice's argument that Ticknor negotiated the changes embodied in the addenda. In fact, Ticknor testified that he had not requested Addendum No. 1, which reduced Ticknor's liquidated damages, and that it was added by Choice unilaterally "because of the disagreements they'd had with franchisees in the past." He also testified that the second addendum, which listed specific changes and additions Ticknor was required to make to the hotel, was

created after Rod McKee, one of Choice's management personnel, inspected the Bozeman hotel site without Ticknor's presence or input. To dispute this, Choice submitted the affidavit of its Senior Vice President and General Counsel, Michael J. Desantis, stating that, "[a]ccording to [Choice's business] records, plaintiffs . . . negotiated several changes to [the Agreement]." However, Desantis did not participate in any such negotiations (Ticknor had never even met him), and Choice did not present any of the business records that purportedly reflected the negotiations. Given these facts, we conclude that the district court did not err in concluding that the Franchise Agreement was an adhesion contract under Montana law.

The fact that a contract is one of adhesion is not dispositive under Montana law. *Passage v. Prudential-Bache Sec., Inc.*, 727 P.2d 1298, 1302 (1986) ("We conclude that even if the customer agreement form is an adhesion contract, there is nothing in the record and no compelling law to prevent enforcement of the arbitration clause."). The second step in the *Iwen* analysis is to ascertain whether the contract is (1) not within that party's reasonable expectations, or (2) if within those expectations, it is unduly oppressive, unconscionable, or against public policy. 977 P.2d at 994-95. Here, the district court concluded that the arbitration clause was unconscionable under Montana law because it required binding arbitration of the weaker bargaining party's claims, but allowed the stronger bargaining party the opportunity to seek judicial remedies to enforce contractual obligations. There is no requirement under Montana law that "arbitration agreements must contain mutual promises that give parties identical rights and obligations or that the parties must

be bound in the exact same manner." *Id.* at 996. However, "the disparities in the rights of the contracting parties must not be so one-sided and unreasonably favorable to the drafter . . . that the agreement becomes unconscionable and oppressive." *Id.*

The arbitration clause in this case allowed Choice to bring its claims against Ticknor into state or federal court, yet forced Ticknor to submit all claims to binding arbitration at Choice's headquarters in Maryland. *Iwen* involved an almost identical situation, leading the Montana Supreme Court to reach the conclusion that the clause was unenforceable. *Id.* at 993. Thus, applying *Iwen*, the arbitration provision in this case "lacks mutuality of obligation, is one-sided, and contains terms that are unreasonably favorable to the drafter." *Id.* at 996.

Choice suggests that, because it initially sought arbitration as to whether franchise fees were due – which it was not obligated to do under the Franchise Agreement – mutuality of arbitration remedy exists under the contract. However, it is the contractual terms, not the subsequent behavior of the parties, that determines whether a clause may be deemed unenforceable as unconscionable. *See id.* In addition, Choice has withdrawn its request for arbitration of its affirmative claims, removing the factual underpinnings of its argument.

It is arguable that Montana law as established by *Iwen* and its predecessors is limited to consumer contracts – where the inequality of bargaining power is readily apparent – and does not apply to a commercial transaction between supposedly sophisticated business owners. In the past, Montana law has occasionally evolved in

similar contexts. *Compare Dunfee v. Baskin-Robbins, Inc.* 720 P.2d 1148, 1153 (1986), *with Story v. City of Bozeman,* 791 P.2d 767, 773 (1990). However, as written, *Iwen* is not limited to the consumer context; in fact, it applied "generally applicable contract defenses." 977 P.2d at 944. In addition, the Montana Supreme Court had previously held that "[o]ppression and a disparity of bargaining power are the indicia of unconscionability relating to a sales contract between two business professionals." *In re Michael,* 871 P.2d 272, 275 (1994) (citing *All-States Leasing v. Top Hat Lounge,* 649 P.2d 1250, 1253 (1982)). Thus, it would be entirely speculative to conclude that the Montana Supreme Court might in the future be inclined to "review the current state of the law and to make mid-course corrections." *Story,* 791 P.2d at 772. In analyzing state law in diversity cases, we must take the law as we find it – not how we might imagine that it might or should evolve. *Moore,* 789 F.2d at 1327.

In view of these considerations, we conclude that the district court correctly determined that the Montana Supreme Court would likely hold that the arbitration provision of the Franchise Agreement was unenforceable as unconscionable under Montana law.

V

The fact that the arbitration provision is unenforceable under Montana law does not end our inquiry; we must also determine whether Montana's construction of the unconscionability of arbitration clauses is preempted by the Federal Arbitration Act. That analysis is guided by the Supreme Court's decision in *Doctor's Associates,*

another case originating from Montana. Under *Doctor's Associates*, "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." 517 U.S. at 687, 116 S.Ct. 1652. However, "[c]ourts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." 517 U.S. at 687, 116 S.Ct. 1652 (emphasis in original). In other words, state legislation specifically aimed at arbitration agreements is preempted by the Federal Arbitration Act. In all situations where arbitration provisions are "placed upon the same footing as other contracts," *see id.* (internal quotation marks and citation omitted), state law applies.

The Montana Supreme Court addressed the limitations of *Doctor's Associates* in *Iwen*, explaining that Montana law pertaining to the unconscionability of arbitration clauses was the result of the "application of general principles that exist at law or in equity for the revocation of any contract." 977 P.2d at 996. Thus, Montana law concerning arbitration clauses in adhesion contracts does not run afoul of *Doctor's Associates*.

The Supreme Court's decision in *Doctor's Associates* does, however, cause us to reconsider our prior decisions in *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 286 (9th Cir. 1988), and *Bayma v. Smith Barney, Harris Upham and Co.*, 784 F.2d 1023 (9th Cir. 1986). Because certain aspects of *Cohen* and *Bayma* cannot be reconciled with *Doctor's Associates*, we must overrule them insofar as they hold that state law adhesion contract principles may not be invoked to bar arbitrability of disputes under the Arbitration Act. *See Interactive Flight Techs., Inc. v. Swissair Swiss Air Transport Co., Ltd.*, 249 F.3d 1177, 1179 (9th Cir.

2001) (applying rule that three-judge panels may depart from circuit precedent that is inconsistent with an intervening Supreme Court decision).

VI

In sum, the district court did not err in denying the motion to dismiss or, in the alternative, to compel arbitration. The arbitration clause in the Franchise Agreement was unenforceable as unconscionable under Montana law, which was not preempted by the Federal Arbitration Act.

AFFIRMED.

TASHIMA, Circuit Judge, dissenting:

Because I do not believe that the contract at issue was an adhesion contract or that its arbitration clause was so one-sided as to make it unconscionable, I respectfully dissent. The arbitration clause does not violate Montana's public policy; therefore, Maryland law should apply. Because I also conclude that Maryland law would not prevent the enforcement of the arbitration clause, I would reverse the district court's denial of Choice's motion to dismiss or to compel arbitration.[1]

---

[1] Although not entirely free from doubt, I accept for purposes of this dissent the majority's conclusion that the judicially-created Montana rule, making one-sided arbitration clauses in adhesion contracts unenforceable, does not run afoul of *Doctor's Assoc., Inc. v. Casarotto*, 517 U.S. 681 (2000). *See* maj. op. at 13092. Similarly, it is not at all clear, contrary to the majority's assertion, that "Montana has a materially greater interest in the transaction than does Maryland," *id.* at 13087, in

The concept of adhesion first arose in the insurance context, *see Fitzgerald v. Aetna Ins. Co.*, 577 P.2d 370, 373 (1978) (finding "insurance policy [to be] an adhesion contract"), but has since been applied to other areas. *See, e.g., Anderson v. Baker*, 641 P.2d 1035, 1039 (1982) (consumer and bank); *Passage v. Prudential-Bache Sec., Inc.*, 727 P.2d 1298, 1301 (Mont. 1986) (finding a contract of adhesion where consumer was "faced with an industry wide practice of including Arbitration Clauses in standardized brokerage contracts" and thus "face[d] the possibility of being excluded from the securities market unless he accept[ed] a contract with such an agreement to arbitrate"); *Iwen v. U.S. West Direct*, 977 P.2d 989, 995 (Mont. 1999) (finding a contract of adhesion between a consumer and telephone company because consumer had no opportunity to negotiate agreement for advertising in the Yellow Pages). As these cases demonstrate, however, Montana has used the adhesion doctrine to protect unsophisticated *consumers* in consumer transactions with no meaningful choice. The rule of adhesion has never been applied to commercial contracts between sophisticated business organizations.[2]

---

this action in which none of the parties is a resident or domiciliary of, or is headquartered in, Montana. I accept this conclusion also, however, for the purposes of the analysis that follows.

[2] Recognizing that its application of the adhesion doctrine to this commercial contract is anomalous, the majority purports to "take the law as we find it." Maj. op. at 10392. In its very next sentence, however, the majority concedes that what it in fact is doing is predicting what "the Montana Supreme Court would likely hold." *Id.*

Plaintiffs are not unsophisticated "consumers" under any definition of the term and this is not a consumer transaction. Ticknor Lodging Corp., the contracting party and primary plaintiff, owns and operates at least two hotel properties-the one at issue and another in Colorado. Plaintiffs have been operating these properties under franchise agreements with two separate franchisors-one with Prime Rate and the other with Redwood Lodge. Ticknor is an experienced and sophisticated motel franchise operator. Additionally, unlike the plaintiffs in the cases cited above, the Ticknors have not demonstrated that they had no other viable alternatives, *i.e.*, that they "face [d] the possibility of being excluded from the [hotel franchise] market unless [they] accept[ed] a contract with such an agreement to arbitrate." *Passage*, 727 P.2d at 1301.[3] Rather, the record suggests that plaintiffs made a conscious decision to change their affiliation because they believed that the Econo Lodge mark and system would increase their profitability. They willingly accepted the negotiated burdens of the new franchise agreement in return for the expected benefits of the Econo Lodge

---

[3] Indeed, plaintiffs presumably could have continued their relationship with Prime Rate.

mark.[4] In other words, plaintiffs had not only a theoretical, but also an actual, choice. No adhesion contract was crammed down their throat.

This is in direct contrast to the case solely relied upon by the majority. In *Iwen*, the plaintiff-a consumer seeking to place an ad in the Yellow Pages-was faced with a Hobson's choice: either accept the contract as presented, or forego advertising with the only publisher of Yellow Pages in the relevant marketing area. On that fact alone, the case is distinguishable.[5]

Furthermore, even if the contract is one of adhesion, I do not agree that *Iwen* dictates a finding of unconscionability. It is true, as the Majority contends, that the parties' obligations to arbitrate differ in some respect.[6]

---

[4] Contrary to the majority's assertion, this was a negotiated transaction. In its choice of law analysis, the district court expressly found that "*[n]egotiations took place* between James Ticknor and a Choice representative in Montana." Maj. op. at 13086 (emphasis added). The majority does not challenge this finding as clearly erroneous; in fact, it relies on it in concluding that the district court's choice of law analysis was correct.

[5] Under the majority's rule, every form contract between parties of even slightly unequal bargaining power is a contract of adhesion – and thus is prone to invalidation. Clearly, the Montana Supreme Court did not envision such a rule.

[6] These differences, however, are immaterial to the mutuality analysis. Choice reserved its right to sue for three things: indemnity, trademark enforcement, and moneys owed under the contract. At first glance, it may seem unfair to allow Choice, but not Ticknor, to sue for these breaches. But, Ticknor does not have a right of indemnification against Choice, nor does it have any trademark rights to protect. It makes sense that indemnification claims are not required to be arbitrated because

But should either party wish to proceed against the other for almost any obligation *under the contract*, that party must do so through arbitration. Thus, in that respect, there is complete mutuality of obligations.[7] By comparison, in *Iwen*, "the sole remedy for either party [was] the cost of the advertisement." 977 P.2d at 996. In enforcing this remedy, the "stronger" party could go to court while the "weaker" party was limited to arbitration. *Id.* at 995-96. The court found that arrangement unconscionable. Once again, the parties' remedies here are not so limited. As such, the clause is not so one-sided as to be unconscionable under Montana law.

We recently noted that the unconscionability analysis has two prongs- procedural unconscionability (the manner and circumstances of contract formation, *i.e.*, was it

---

they invariably arise out of third-party claims which are often already in litigation, where the convenient remedy, if tender of the defense is rejected, is to bring a third-party claim for indemnification. As for trademark claims, the classic remedy for infringement is a federal court injunction, a remedy an arbitrator has no power to enforce. Furthermore, Ticknor could not file an action for "collection of moneys . . . under this Agreement" because Choice has no monetary obligations to Ticknor under the contract. Thus, in the mutuality analysis, it makes no difference that Choice is not required to arbitrate these claims. Like the Ticknors, Choice is required to arbitrate all of its other claims under the agreement.

[7] For instance, any breach by Ticknor unrelated to payment of monies owed would be arbitrable. Such breaches, for example, could include a failure to follow the aesthetic rules or a failure to maintain insurance. Ironically, in fact, in this case, it was Choice who sought to arbitrate *its claims* under the agreement and plaintiffs who are attempting to avoid arbitration of Choice's claims.

truly a contract of adhesion), and substantive unconscionability (which analyzes the terms of the agreement, *i.e.*, is so one-sided as to *shock the conscience*). *Soltani v. West. & So. Life Ins. Co.*, No. 9956612, 2001 WL 877156, at *3-*4 (9th Cir. Aug. 6, 2001). Although *Soltani* was a case under California law, our analysis here should proceed in the same way, with the same objective. Under such an analysis, this clearly is not an unenforceable adhesion contract-there was neither procedural unconscionability nor substantive unconscionability-and the agreement should be enforced. *See id.*

Because the arbitration clause does not violate Montana law, the parties' choice of law should be enforced and Maryland law applied to this dispute. Maryland courts "treat the mutual promises to arbitrate as an independently enforceable contract. The parties have exchanged mutual promises to arbitrate disputes under the contract and each promise provides consideration for the other." *Holmes v. Coverall N. Am., Inc.*, 649 A.2d 365, 370 (Ct. App. Md. 1994). Thus, as long as "there are no infirmities in the formation of the arbitration agreement itself; that is, that there is a mutual exchange of promises to arbitrate, . . . [the court's] inquiry ceases, as the agreement to arbitrate has been established as a valid and enforceable contract." *Id.* Here, as stated above, there is a mutual exchange of promises to arbitrate mutually-assertable claims. Therefore, under Maryland law, the arbitration clause is enforceable.

The district court's order should be reversed and the case remanded with directions to grant Choice's motion to compel arbitration.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
BUTTE DIVISION

JAMES L. TICKNOR, JANET TICKNOR, LARRY TICKNOR, TICKCO HOLDING, L.L.C., and TICKNOR LODGING CORPORATION, Plaintiff, vs. CHOICE HOTELS INTERNATIONAL, INC., Defendant.	CV 99-47-BU-DWM ORDER (Filed Dec. 6, 1999)

Before the Court are Defendant Choice's motion to dismiss or, in the alternative, to compel arbitration, and Plaintiff Ticknors' motion for a preliminary injunction against arbitration. The Ticknors filed this action seeking a declaratory judgment that the arbitration clause in the franchise contract between the parties was invalid and unenforceable.

I. Factual & Procedural Background

On February 24, 1998, James Ticknor and Ticknor Lodging Corp., signed an EconoLodge Franchise Agreement ("the Agreement") with Choice Hotels, Inc. On the same date, Larry and Janet Ticknor and Tickco Holding Co., LLC, as well as James Ticknor, signed a Guaranty referring to the Agreement. Choice signed on March 10,

1998. The Agreement required Choice to provide the Ticknors with a nonexclusive license to use EconoLodge trademarks, integration into its national advertising and reservations system, hardware and software to make the reservation system operable, and a manual governing the daily operation of the hotel (Agreement ¶ 5(c), (d)). The Ticknors were obligated to pay franchise fees (¶ 4), operate the hotel in conformity with EconoLodge standard practices (¶ 6), and upgrade the hotel to bring it into conformity with standard EconoLodge layout (Agreement Addendum No. 2).[1]

After the Agreement was signed, Choice announced cancellation of its "Signature Exterior Renovation Program," obviating any possibility for the Ticknors to obtain assistance with the upgrade. The Ticknors allege that the reservation system was faulty as well, resulting in overbooking, and that the relationship between hardware and software was less than harmonious. Consequently, the Ticknors suspended their performance.

On March 23, 1999, Choice notified the Ticknors that it was terminating the Agreement, effective immediately, because the Ticknors defaulted in payment of their franchise and related fees. On July 8, 1999, Choice filed a demand for arbitration with the American Arbitration Association. The Ticknors filed a complaint in state court on August 9, 1999, seeking a temporary restraining order and preliminary injunction prohibiting Choice from proceeding with arbitration. On August 16, Choice removed

---

[1] The parties question the scope of the Guaranty. I refer to "the Ticknors" collectively only for the sake of convenience.

the case to this Court. On August 19, Choice moved to dismiss or, in the alternative, to compel arbitration.

The Court denied the Ticknors' application for a temporary restraining order on September 9. I heard oral argument on their motion for a preliminary injunction on September 15. At the hearing, Choice agreed to delay arbitration proceedings until the motions were decided. On October 18, Choice filed a notice of withdrawal of the July 8 demand for arbitration. Choice's motion to dismiss or compel arbitration remains pending, as does the Ticknors' motion for a preliminary injunction.

II. Analysis

The Ticknors argue that the arbitration clause is unenforceable under Montana law because it is part of an unconscionable contract of adhesion. Choice argues that the clause is valid and enforceable because the contract is not one of adhesion. Choice also argues that Maryland law should apply because the contract contains a choice of law provision.

A. Choice of Law

There is no dispute that the action falls under the Federal Arbitration Act ("the Act"). 9 U.S.C. § 2 provides that a written agreement to arbitrate a contract "evidencing [a] transaction[ ] in commerce" is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." As an exercise of Congress' Commerce Clause powers, the

phrase "transaction in commerce" is very broadly construed and undoubtedly includes franchise agreements. *See, e.g., Southland Corp. v. Keating*, 465 U.S. 1 (1984) (assuming that a 7-Eleven franchise agreement evidences a transaction in interstate commerce). Thus, the Act applies to this case.

However, state law provides the law of decision. *See* 9 U.S.C. § 2. When a Montana court, state or federal, must decide whether to give effect to a choice of law provisions, it must consider the Restatement (Second) of Conflict of Laws § 187(2) (1971). *Keystone, Inc. v. Triad Sys. Corp.*, 1998 MT 326, ___ Mont. ___, 971 P.2d 1240 (Mont. 1998); *Casarotto v. Lombardi*, 268 Mont. 369, 886 P.2d 931 (Mont. 1994), *rev'd on other grounds, Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996); *Rindal v. Seckler*, 786 F. Supp. 890 (D. Mont. 1992).

Under the Restatement, the choice of law provision prevails unless "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which . . . would be the state of the applicable law in the absence of an effective choice of law by the parties." Restatement (Second) of Conflict of Laws § 187(2)(b) (1971).

Section 188 of the Restatement determines which state has a materially greater interest and which state's law would apply absent the parties' choice of law. Five factors are considered: (a) the place of contracting; (b) the place of negotiation of the contract; (c) the place of performance; (d) the location of the subject matter of the

contract; and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties. Restatement (Second) of Conflict of Laws § 188(2).

In this case, the contract was signed in both Montana and Maryland. Negotiations took place between James Ticknor and a Choice representative in Montana. The parties performed most of their obligations in Montana, although the Ticknors mailed their franchise and related fees to Maryland. The EconoLodge was located in Butte, Montana. Choice is incorporated in Delaware and has its headquarters in Maryland. The Ticknors live and work in Montana. The subject matter of the contract, the place of performance, and the negotiations preceding the Agreement all are rooted in Montana. Clearly, Montana has a greater material interest in this Agreement, and Montana's law would govern absent the parties' choice of Maryland law.

The next question is whether application of Maryland law would defeat a fundamental public policy of Montana. Montana decisional law is clear that choice of forum provisions contravene Montana public policy. *See Rindal*, 786 F. Supp. at 894; *State ex rel. Polaris Indus.*, 215 Mont. at 111, 695 P.2d at 472. However, the Montana Supreme Court has not determined whether application of Maryland law would defeat Montana public policy when the particular issue to be decided is not choice of forum but unconscionability.

This determination is not difficult to make. "Unconscionable" is but another name for "contrary to fundamental policy." It stands to reason that determination of unconscionability issues under another state's law would

be contrary to Montana's fundamental policy of protecting its citizens from agreements that are contrary to Montana's fundamental policies. Applying Maryland law to determine this issue would be unconscionable.[2]

The Ninth Circuit has stated that "state law adhesion contract principles may not be invoked to bar arbitrability of disputes under the [Federal] Arbitration Act." *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 286 (9th Cir. 1988) (citing *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F.2d 1023, 1024-25 (9th Cir. 1986). The *Bayma* decision is no longer good law, if it ever was. The Federal Arbitration Act itself makes state law the law of decision. *See* 9 U.S.C. § 2 (a written agreement to arbitrate a contract is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."). The United States Supreme Court honors that language. *See Doctor's Assocs., Inc.*, 517 U.S. at 687 ("[T]he text of § 2 declares that state law may be applied 'if that law arose to govern issues concerning the

---

[2] Note that this arbitration clause is probably unenforceable under Maryland law. *See, e.g., Holmes v. Coverall N. Am. Inc.*, 649 A.2d 365, 369-70 (Md. 1994) (discussing separability doctrine and *Hull v. Norcom, Inc.*, 750 F.2d 1547, 1550 (11th Cir. 1985), which "refus[ed] to enforce arbitration clause in case alleging fraud in the inducement of a contract because the unilateral ability of one of the parties to bring certain claims in court evidenced insufficient consideration to support the validity of the arbitration clause."). Here, however, the question is not whether the arbitration clause would be enforceable under Maryland law but whether Montana or Maryland should apply to determine whether the arbitration clause is enforceable.

validity, revocability, and enforceability of contracts generally.' ") (quoting *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987)). Moreover, there is no federal law of contracts and there is no federal test of unconscionability. State law *must* supply the laws and tests to determine whether an arbitration clause is enforceable.

B. The Arbitration Clause Under Montana Law

In the light of Montana law, the arbitration clause must be examined in isolation from the remainder of the contract. That a contract as a whole is one of adhesion under state law principles will not preclude arbitration. *Republic of Nicaragua v. Standard Fruit Co.*, 937 F.2d 469, 476 (9th Cir. 1991), pointed out that "[a]n arbitration clause may thus be enforced even though the rest of the contract is later held to be invalid by the arbitrator" (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967)). In other words, it is up to the arbitrator to decide whether the contract is enforceable; the court may only decide whether the arbitration clause is enforceable.

The arbitration clause, in full, provides:

> ¶ 22. Arbitration. Except for our claims against you[3] for indemnification, actions for collections of moneys owed us under this Agreement, or actions seeking to enjoin you from using the Marks in violation of this Agreement, any controversy or claim relating to this Agreement, or the breach of this Agreement, including any

---

[3] Choice is the party of the first-person plural; the Ticknors are the party of the second-person plural.

> claim that this Agreement or any part of this Agreement is invalid, illegal, or otherwise voidable or void, will be sent to final and binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. The arbitrator will apply the substantive laws of Maryland, without reference to its conflict of laws provision. Judgment on the arbitration award may be entered in any court having jurisdiction. If any party fails to appear at any properly noticed arbitration proceeding, an award may be entered against the party, notwithstanding its failure to appear. Any arbitration will be conducted at our headquarters office in Maryland.

This clause plainly does not state that the parties agree to submit disputes concerning Choice's entitlement to "moneys owed us under this Agreement" to arbitration. It *excepts* Choice's claims for such moneys from matters that "will" be arbitrated.

Despite the strong Congressional policy favoring arbitration, a party cannot be compelled to arbitrate if it has not agreed to do so. Neither party agreed that Choice's claims would be arbitrated. Consequently, Choice's motion to compel the Ticknors to arbitrate, insofar as Choice contemplates arbitration of its franchise fee claim, must be denied.

Furthermore, insofar as the arbitration clause purports to compel the parties to arbitrate in Maryland, it is clearly invalid under Montana law. *See Keystone, Inc. v. Triad Sys. Corp.*, 1998 MT 326, ___ Mont. ___, 971 P.2d

1240, 1242-43 (Mont. 1998) (holding choice of forum provision invalid, readopting Restatement (Second) of Conflict of Laws § 187(2) (1971), and reaffirming *Casarotto v. Lombardi*, 268 Mont. 369, 886 P.2d 931 (Mont. 1994), *rev'd on other grounds, Doctor's Assocs. Inc.*, 517 U.S. at 687-88).

However, the motion to compel could apply to the Ticknors' claims for declaratory judgment that Choice is not entitled to its franchise and related fees and that the Ticknors are entitled to rescission, damages for breach of contract, negligent misrepresentation, and actual and constructive fraud, and to punitive damages. Thus, the Court must still decide whether those issues are arbitrable.

In the recent case of *Iwen v. U.S. West Direct*, 1999 MT 63, ___ Mont. ___, 977 P.2d 989 (Mont. 1999), the Montana Supreme Court reversed a trial court's order of arbitration on the grounds that the arbitration provision was unconscionable in a contract of adhesion. *Iwen* concerned an arbitration clause strikingly similar to the clause in Choice's franchise agreement:

> Any controversy or claim arising out of or relating to this Agreement, or breach thereof, other than an action by the Publisher for the collection of the amounts due under this Agreement, shall be settled by final, binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association.

Iwen at ¶ 31, 977 P.2d at 995.

To determine whether this clause was enforceable, the Montana Supreme Court applied three analytic steps. First, it determined whether the contract was one of

adhesion. Second, it determined whether the provision could pass a two-prong test for validity: (a) the provision must be within the reasonable expectations of the weaker party and (b) it must not be unduly oppressive, unconscionable, or against public policy when considered in context. *See Passage v. Prudential-Bache Sec., Inc.*, 223 Mont. 60, 66, 727 P.2d 1298, 1302 (Mont. 1986).

In Montana, contracts of adhesion "arise when a standardized form of agreement, usually drafted by the party having superior bargaining power, is presented to a party whose choice is either to accept or reject the contract without the opportunity to negotiate its terms." *Iwen* at ¶ 28, 977 P.2d at 995. Testimony at the hearing established that the arbitration clause, along with the rest of the agreement, was presented as a "take it or leave it" proposition, although the parties did add one addendum to the standard agreement.[4] Choice drafted the agreement. Considering only the arbitration clause, the evidence indicates it is a contract of adhesion.

The next question is whether the arbitration agreement either violated the Ticknors' reasonable expectations or was unduly oppressive, unconscionable, or against public policy. As the Montana Supreme Court stated in *Iwen*, "[One party] pointedly protected itself by preserving its constitutional right of access to the judicial

---

[4] Addendum No. 1 is included within Addendum No. 2. The Court notes that the addendum does not impose any new obligations on Choice. It imposes many new obligations on the Ticknors, and Choice agrees to a 3-year rather than 5-year multiplier in the calculation of its liquidated damages in the event of the Ticknors' untimely termination.

system while at the same time [it] completely removed that right from the [other]." *Id.* at ¶ 31, 977 P.2d at 996. "Drafted as such, the weaker bargaining party has no choice but to settle all claims arising out of the contract through final and binding arbitration, whereas the more powerful bargaining party and drafter has the unilateral right to settle a dispute for collection of fees pursuant to the agreement in a court of law." *Id.* at ¶ 31, 977 P.2d at 995. The arbitration clause in *Iwen* was unconscionable.

So is the clause in Choice's contract. In addition to reserving the right of access to the courts and to juries for itself alone, Choice requires its franchisees to travel to Maryland, a hardship that a court of law could not impose because of the due process requirements for personal jurisdiction.

III. Conclusion

The arbitration clause in this Agreement is inequitable. Whether it lacks consideration under Maryland law or is unconscionable under Montana law, Choice cannot enforce it against the Ticknors.

Accordingly, Defendant Choice Hotels' motion to dismiss or, in the alternative, to compel arbitration (dkt # 2) is DENIED. Plaintiff Ticknors' motion for a preliminary injunction (dkt # 5) is DENIED AS MOOT. The arbitration clause is unenforceable under the facts of this case. A preliminary pretrial scheduling order accompanies this Order.

DATED this 6th day of December, 1999.

/s/ Donald W. Molloy
DONALD W. MOLLOY
UNITED STATES DISTRICT
JUDGE

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1 – GENERAL PROVISIONS

§ 1. "Maritime transactions" and "commerce" defined; exceptions to operation of title

"Maritime transactions", as herein defined, means charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction; "commerce", as herein defined, means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1 – GENERAL PROVISIONS

§ 2. Validity, irrevocability and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to

settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1 – GENERAL PROVISIONS

§ 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

UNITED STATES CODE ANNOTATED
TITLE 9. ARBITRATION
CHAPTER 1 – GENERAL PROVISIONS

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and

determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

UNITED STATES CODE ANNOTATED
TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
PART IV – JURISDICTION AND VENUE
CHAPTER 89 – DISTRICT COURTS; REMOVAL OF CASES FROM STATE COURTS

§ 1441. Actions removable generally

(a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending. For purposes of removal under this chapter, the citizenship of defendants sued under fictitious names shall be disregarded.

(b) Any civil action of which the district courts have original jurisdiction founded on a claim or right arising under the Constitution, treaties or laws of the United States shall be removable without regard to the citizenship or residence of the parties. Any other such action shall be removable only if none of the parties in interest properly joined and served as defendants is a citizen of the State in which such action is brought.

(c) Whenever a separate and independent claim or cause of action within the jurisdiction conferred by section 1331 of this title is joined with one or more otherwise non-removable claims or causes of action, the entire case may be removed and the district court may determine all issues therein, or, in its discretion, may remand all matters in which State law predominates.

(d) Any civil action brought in a State court against a foreign state as defined in section 1603(a) of this title may be removed by the foreign state to the district court of the United States for the district and division embracing the place where such action is pending. Upon removal the action shall be tried by the court without jury. Where removal is based upon this subsection, the time limitations of section 1446(b) of this chapter may be enlarged at any time for cause shown.

(e) The court to which such civil action is removed is not precluded from hearing and determining any claim in such civil action because the State court from which such civil action is removed did not have jurisdiction over that claim.

Mont. Code Ann. § 27-5-323. Venue. An initial application must be made to the court of the county in which the agreement provides the arbitration hearing must be held or, if the hearing has been held, in the county in which it was held. Otherwise, the application must be made in the county where the adverse party resides or has a place of business or, if he has no residence or place of business in this state, to the court of any county. All subsequent applications must be made to the court hearing the initial application unless the court otherwise directs. No agreement concerning venue involving a resident of this state is valid unless the agreement requires that arbitration occur within the state of Montana. This requirement may only be waived upon the advice of counsel as evidenced by counsel's signature thereto.

Mont. Code Ann. § 28-2-708. Restraints upon legal proceedings void. Every stipulation or condition in a contract by which any party thereto is restricted from enforcing his rights under the contract by the usual proceedings in the ordinary tribunals or which limits the time within which he may thus enforce his rights is void. This section does not affect the validity of an agreement enforceable under Title 27, chapter 5.

Applicable Contract Provisions

20. Severability and Construction

a. If any section of the agreement is held to be illegal, invalid or unenforceable, both parties agree that (1) the section will be removed; (2) this Agreement will be understood and enforced as if the illegal, invalid, or unenforceable section had never been in this Agreement; and (3) the remaining sections will remain in full force and effect and will not be affected by the illegal, invalid, or unenforceable section or by its removal. A section similar to the removed section will be automatically added as a part of this Agreement to the maximum extent enforceable.

* * *

f. This Agreement becomes valid only when we have signed it, and it will be interpreted under the substantive laws of Maryland, not including its conflict of laws provision.

* * *

h. Each party may obtain injunctive relief against threatened conduct that will cause it loss or damages, under the usual equity rules, including the applicable rules for obtaining restraining orders and preliminary injunctions.